Impact Analysis of SMEs Sector in Economic Development of Pakistan: A Case of Sindh

Anwar Ali Shah G. Syed (Pro-Vice Chancellor Sindh University Dadu Campus, Pakistan)

Muhammad Muneer Ahmadani (Ph. D Scholar-University of Sindh-Jamshoro, Pakistan)

Naveed Shaikh (Assistant Professor-Shah Abdul Latif University Khairpur Mirs, Pakistan)

Faiz Muhammad Shaikh (Assistant Professor, SZABAC-Dokri, Pakistan)

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Abstract

This study examines the role of SMEs for the economic development of Pakistan. A comprehensive international literature study was undertaken. The data were collected from the 100 owners/managers and 200 employees of the SMEs of textile industry by using five point Likert scale through the survey of 50 small and medium-sized textile units. The data were analyzed by using descriptive statistics, paired sample t-test and Pearson’s product moment correlation analysis. The results of this study revealed that SMEs are playing a positive and significant role for the economic progress of Pakistan, fundamental role in foreign exchange earnings and GDP of Pakistan. The present study further suggested that SMEs are also providing job opportunities in the country and have a major contribution in export sub-sector of Pakistan.

Keywords: SMEs, economic development, Pakistan and province of Sindh

Introduction

Small and Medium Enterprises (SMEs) played a very vital role in the economic development of the underdeveloped as well as developed countries. The abbreviation SME is commonly used in the European Union countries and also in international organizations, such as the World Bank, the United Nations and the World Trade Organization (WTO). The term Small and Medium Business (SMB) is also prevailing in a few other countries of the world. EU Member countries conventionally had their own definitions of the term SME (Wikipedia, 2008). Small and Medium Enterprises (SMEs) are known as the solution of economic progress, modernization and the development of employment, employment potential, creation of income and scientific progression in most advanced economies. (Acs and Audretsch, 1990; Neck and Dockner, 1987; Kotey and Meredith, 1997, Bhutta and Asad, 2008). Also maintained by Hamid and Abaidullah (2006) that the participation of SME sector to the economy is significant and this is probably to be a feature of SME sector around the world.

What are SMEs?

SMEs are usually enterprises that employ not more than 250 workers. The technical definition varies from country to country in the Asia-Pacific region but is usually based on employment, assets, or a combination of the two. Some countries have different definitions for SMEs in the manufacturing and services sector (Kotelnikov, 2007). SMEs are defined by various ways some authors have given very important definitions of SMEs Fong (1971) defined that SME is a business which does not exceed the 100 employees. Businesses in the SME sector generally turn around the owner/entrepreneur (Carson et al., 1995; Nooteboom, 1994). The same point raised by the Verhees and Meulenberg (2004) that small firm is a business which is controlled and managed by the owner himself.

SME definition approved by SME policy 2007

Pakistan does not have a single definition of Small and Medium Enterprises. Various Government agencies, e.g., State Bank of Pakistan (SBP), Federal Bureau of Statistics (FBS), Provincial Labor Depts., etc. use their
own definition. Absence of a single SME definition makes it difficult to identify target firms, align development programs, collect data and monitor progress (SME Policy, 2007). Government of Pakistan may implement a single SME Definition that is accepted by all public and private agencies. On the other hand, different organizations may be allowed a two-year time frame to harmonize their existing SME definition in line with the SME Definition proposed in this Policy (SME Policy, 2007).

Table 1: SME Definition Recommended by SME Policy 2007

<table>
<thead>
<tr>
<th>Enterprise Category</th>
<th>Employment Size</th>
<th>Paid Up Capital</th>
<th>Annual Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small &amp; Medium Enterprise (SME)</td>
<td>Up to 250</td>
<td>Up to Rs. 25 Million</td>
<td>Up to Rs. 250 Million</td>
</tr>
</tbody>
</table>

Source: SME Policy 2007

Review of literature

SMEs have historically taken as a significant part in contributing to economic progress of many countries around the world (Kongolo, 2010). There is no growth when the advantages of economic improvements are utilized only by a small number of people, whereas the greater parts are being expelled (Todaro and Smith, 2003). The unconstructive effects of current economic turn down have seriously influenced the socio-economic conditions of many people universally. As a reply to these negative conditions, it is necessary that the small, medium and large entrepreneurs improve their employment formation capabilities (Barakat, 2001). It was also pointed out by the Advani (1997) that from the socio-economic development point of view, SMEs provide a variety of benefits. A well-supported and enhanced small business sector is likely to continue contributing to the economic development process in the same way as a large business (Abraham, 2003). One of the noteworthy distinctiveness of a prosperous and emergent economy is a booming and blooming small and medium enterprises (SMEs) sector (Feeney and Riding, 1997).

Feeney and Riding (1997) further argued that small and medium enterprises play an important role in the development of a country. According to Fida (2008) SMEs contribute to economic development in various ways: by creating employment for rural and urban labor force, providing desirable sustainability, and innovation in the economy as a whole. In addition to that, large number of people relies on the small and medium enterprises directly or indirectly. Cook and Nixson (2000) also gave arguments in favor of SMEs and maintained that the growth of SMEs is seen as the way to accelerating the accomplishment of wider socio-economic objectives, including poverty mitigation. The growth and efficiency of small enterprises have also become famous (Mazumdar, 1997). Using the case of Northern Italy, Piore and Sabel (1984) have argued that small enterprises are more efficient because they have adopted a flexible specialization approach. In the same way, there has been growing interest in whether this model has or can be replicated in developing countries (Schmitz, 1989; Pederson, 1994; Schmitz and Musyck, 1994; Schmitz, 1995). Considerable attention has been paid in the last decade to the problem of poverty-reduction in developing countries (World Bank, 1989, 1997). It is generally agreed that the development of micro and small-scale enterprises (MSEs) can be a key ingredient in poverty-reduction (Sen, 1980 and Green et al, 2002). On the other hand, evidence shows that small-scale enterprises contribute significantly to household incomes (Liedholm et al., 1994; McPherson, 1996; Kapoor et al., 1997; Perks, 2004; McDade & Spring, 2005). It is also globally experienced that a well-organized SME sector is favorable to rapid industrial intensification (Hill, 2001, Llyod 2002).

Role of SMEs in economy

The strategic importance of small and medium enterprises in the development of the economy is widely recognized in both developing and developed countries (Abdullah 2000a). SMEs play an important role in the development of national economy of any country. UK economy is 99 % SMEs, so out of the 4.8 million UK businesses less than 1% are large corporations
i.e. over 250 employees (Rowe 2008). (Lee 2000) suggest that in South Korea the share of employment accounted for 70% of total employment and the product share for over 46%. In Malaysia SMEs accounted for about 48% of manufacturing establishment (Abdullah 2000b). There are about 118,648 SMEs in Thailand representing around 98% of total firms in manufacturing sector (Suthiphand 2000). China is fast becoming the largest economies in the world and SMEs are key element in China’s economy accounting for 99% of total number of firms and about 70% of overall employment (Tang 2007).

Participation of small and medium enterprises (SMEs) in economic progress in developed and developing countries is to be considered backbone of the economy. SME sector of Pakistan is playing a very important part in the economic development and succession of technical improvement, sourcing to large scale industrial sector and promote economic renewal and social development. Similarly to other developing countries, largely the economy of Pakistan is also SME based economy. As argued by Ahmad, Rani and Kassim (2011) that SMEs have a major participation to the growth and competitiveness of the economy. As indicated by the Small and Medium Enterprises Development Authority (SMEDA) that SME sector of Pakistan represent approximately 90% of all the enterprises in Pakistan. SMEs almost employed 80% of the non-agricultural work force; and shared about 40% in the annual GDP of the country (Malik, Khan, Bhutto and. Ghouri 2011). The significance of SMEs in economy cannot be underestimated because SMEs are the most important source to reduce poverty, growth in the national economy, basic source of employment and social uplift (Akhtar, Raees and Salaria 2011).

There is evidence that SME sector is performing a historic role in the development of economy. However, on the other hand, the failure ratio of SMEs is alarming for developing as well as developed countries. It was identified by the previous studies that a large numbers of newly established SMEs fail within first five years of their business operation (Zimmerer, Searborough and Wilson 2008; Hodges and Kuratko 2004). Most of the studies from Australia, USA and England proved that almost 80-90 percent of the SMEs fails within 5-10 years (Zimmerer et al. 2008; Hodges and Kuratko 2004; Peacock 1985; Ahmad et al. 2011, correspondingly, as far as Malaysia is concerned there is a shortage of literature and information, therefore, the expected failure rate of SMEs is roughly 60 percent (Portal Komuniti 2006; Ahmad and Seet 2009). on the other hand, in Pakistan the failure rate of SMEs is approximately 90 percent to 95 percent at the preliminary periods (Ullah, Shah, Hassan and Zaman 2011).

SME sector of Pakistan: an overview

As far as Pakistan is concerned the small and medium enterprise (SME) sector is the spine of Pakistan’s economy. According to current estimation, there are roughly 3.2 million business projects in Pakistan. Enterprises employing up to 99 persons and over 90 percent of all private enterprises in the industrial sector and employ nearly, 78 percent of the nonagricultural labors force. They represent 30 percent of national GDP, 25 percent of exports of manufactured goods, and 35 percent of manufacturing value added (Bhutta et al. 2007, SMEDA, 2007, International Finance Corporation, 2008, Kureshi et al. 2009 and Memon et al 2010). It is reported by the Pakistan Economic Survey (2008) that more than 93 percent of the 3.2 million entities fall in the category of SME. The Economic Census of Pakistan (Also called Census of Establishments), published in 2005, reports this figure to be approximately 99 percent. Moreover this sector of economy offers a major share of total value addition and industrial employment in about every part of economies, its participation in the industrial growth and development remains incontrovertible (Kureshi et al, 2009). SMEs today are widely considered as solution of many economic problems. They are considered as great source of reducing unemployment and poverty in the economy. In Pakistan the manufacturing is the largest sector of the economy and has 18.4% contribution to the
Hypotheses
Following are the main hypotheses of the study:

H$_1$ SMEs are playing a very major role in the economy of Pakistan
H$_2$ SMEs are the major source of foreign exchange earnings
H$_3$ SMEs have a major contribution in Pakistan’s GDP

Research methodology
This study follows a quantitative research design using a survey questionnaire method pooled with a statistical management. A questionnaire was used to obtain responses from the owners/managers and employees of SMEs in textile industry of Pakistan. The sample was selected from the SMEs in textile industry.

The sample
As it is impossible financially and physically, to survey all the Small and Medium Enterprises (SMEs) in all the categories i.e. manufacturing, trading and service sector. Therefore, researcher has randomly selected SMEs in textile industry for the purpose of this study. According to the list provided by the Department of Industries Government of Sindh, the total textile industries in Sindh are 655. While scrutinizing of the list in the light of general definition of SMEs given by the Small and Medium Enterprises Development Authority (SMEDA) there were hardly 400 textile industries which were treated as SMEs out of 655 textile industries. The researcher surveyed 50 SMEs in textile industry that become 12.5% of 400 SMEs in textile industry. The District wise break up is given in the following table 2

Table 2: District wise break up of SMEs in textile industries which were surveyed

<table>
<thead>
<tr>
<th>S.#</th>
<th>Name of District</th>
<th>No. of industries surveyed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Karachi</td>
<td>18</td>
</tr>
<tr>
<td>2</td>
<td>Hyderabad</td>
<td>07</td>
</tr>
<tr>
<td>3</td>
<td>Sanghar</td>
<td>20</td>
</tr>
<tr>
<td>4</td>
<td>Matiari</td>
<td>05</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>50</td>
</tr>
</tbody>
</table>

The sector wise break up is given in the following table 3

Table 3: Sector wise break up of SMEs in textile industry were surveyed

<table>
<thead>
<tr>
<th>S.#</th>
<th>Name of sector</th>
<th>No. of industries surveyed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Cotton Ginning Sector</td>
<td>25</td>
</tr>
<tr>
<td>2</td>
<td>Weaving Sector</td>
<td>10</td>
</tr>
<tr>
<td>3</td>
<td>Readymade Garments</td>
<td>15</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>50</td>
</tr>
</tbody>
</table>

The manageral sample
The managerial sample includes 100 owners and managers drawn from three sectors of SMEs in textile industry at various worksites two from each industry. Table 4 shows the distribution of participants under this study according to SMEs sample. Thus the ginning factories represented 50 percent, weaving industries 20 percent and garment factories 30 percent of the management sample.

Table 4: Distribution of managers sample (N=100)

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of Sector</th>
<th>Number of respondents</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>ginning factories</td>
<td>50</td>
<td>50%</td>
</tr>
<tr>
<td>2</td>
<td>weaving industries</td>
<td>20</td>
<td>20%</td>
</tr>
<tr>
<td>3</td>
<td>garment factories</td>
<td>30</td>
<td>30%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>100</td>
<td>100%</td>
</tr>
</tbody>
</table>

The Employees Sample
The employees sample numbered 200 (four from each industry) which were drawn from three sample SMEs in textile industry at the same worksites as in the managerial sample. Table 5 indicates the distribution of respondents under this study. Therefore ginning factories contributed 50 percent, weaving industries accounted for 20 percent and garment factories contributed 30 percent of total employees’ sample.

Table 5: Distribution of employees sample (N=200)

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of Sector</th>
<th>Number of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>ginning factories</td>
<td>100</td>
</tr>
<tr>
<td>2</td>
<td>weaving industries</td>
<td>40</td>
</tr>
<tr>
<td>3</td>
<td>garment factories</td>
<td>60</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>200</td>
</tr>
</tbody>
</table>
Table 5: Distribution of employees sample (N=200)

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of Sector</th>
<th>Number of respondents</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>ginning factories</td>
<td>100</td>
<td>50%</td>
</tr>
<tr>
<td>2</td>
<td>weaving industries</td>
<td>40</td>
<td>20%</td>
</tr>
<tr>
<td>3</td>
<td>garment factories</td>
<td>60</td>
<td>30%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>200</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Survey instrument

The survey instrument was based on the study by Syed (1988). The survey instrument asked questions about the firms’ economic importance. All the questions were asked using the five-point Likert scale (ranking from strongly agree-------------strongly disagree).

Statistical analysis of data

The methods of analysis used in the present study were smoothly progress with the help of computer programs available in the Statistical Package for the Social Sciences (SPSS) package (Nie et al. 1983). This package was also used by Syed (1988).

Table 6: Economic importance of SMEs comparison of perceptions between two groups (managers and employees)

<table>
<thead>
<tr>
<th>Items</th>
<th>Managements (n=100)</th>
<th>Employees (n=200)</th>
<th>t</th>
<th>p</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. SMEs play a very major role in the economy of Pakistan.</td>
<td>20 11.423</td>
<td>40 19.196</td>
<td>-5.484</td>
<td>0.005</td>
</tr>
<tr>
<td>b. SMEs are the major source of foreign exchange earnings.</td>
<td>20 9.219</td>
<td>40 17.818</td>
<td>-4.576</td>
<td>0.010</td>
</tr>
<tr>
<td>c. SMEs create the best rising export sub-sectors.</td>
<td>20 9.137</td>
<td>40 13.564</td>
<td>-7.845</td>
<td>0.001</td>
</tr>
<tr>
<td>d. SMEs have a major contribution in Pakistan’s GDP.</td>
<td>20 8.803</td>
<td>40 18.520</td>
<td>-4.495</td>
<td>0.011</td>
</tr>
<tr>
<td>e. A known feature of SME sector is its ability to create jobs.</td>
<td>20 9.565</td>
<td>40 19.065</td>
<td>-4.216</td>
<td>0.014</td>
</tr>
<tr>
<td>f. SMEs maintain the poverty alleviation activities through creating employment.</td>
<td>20 11.067</td>
<td>40 18.801</td>
<td>-4.808</td>
<td>0.009</td>
</tr>
<tr>
<td>g. SMEs in general consider employees as their most important resources</td>
<td>20 6.708</td>
<td>40 13.416</td>
<td>-5.216</td>
<td>0.006</td>
</tr>
</tbody>
</table>

Coefficient and correlation of economic importance of SMEs items showed a positive and significant relationship of the views of managers and employees among the six items out of seven items which indicated that SMEs are playing a positive and significant role in the eco-

Results and discussions

A paired sample t-test was used to examine the differences of opinion between the managers and the employees groups of the samples of SMEs in textile industry. In this respect a significant difference was found among both the groups relating to all the seven items of economic importance of SMEs these items were: SMEs play a very major role in the economy of Pakistan; foreign exchange earnings, create the best rising export sub-sectors, major contribution in Pakistan’s GDP, create jobs opportunities, maintain the poverty alleviation activities through creating employment, and finally, consider employees as their most important resources, which indicated that there appeared to be a positive and significant impact of SMEs on the economy of Pakistan as shown in the following table 6.
nomy of Pakistan, foreign exchange earnings, exports, GDP, job creation, poverty alleviation. However, the opinions of managers and the employees on the issue of SMEs in general consider employees as their most important resources were not positively and significantly correlated as shown in the following table 7

Table 7: Economic importance of SMEs coefficient of correlation between two groups (managers and employees)

<table>
<thead>
<tr>
<th>S. #</th>
<th>Items</th>
<th>N</th>
<th>Correlation</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>a. SMEs play a very major role in the economy of Pakistan.</td>
<td>5</td>
<td>0.986</td>
<td>0.002</td>
</tr>
<tr>
<td>2</td>
<td>b. SMEs are the major source of foreign exchange earnings.</td>
<td>5</td>
<td>0.934</td>
<td>0.020</td>
</tr>
<tr>
<td>3</td>
<td>f. SMEs create the best rising export sub-sectors</td>
<td>5</td>
<td>0.948</td>
<td>0.014</td>
</tr>
<tr>
<td>4</td>
<td>c. SMEs have a major contribution in Pakistan’s GDP</td>
<td>5</td>
<td>0.986</td>
<td>0.002</td>
</tr>
<tr>
<td>5</td>
<td>d. A known feature of SME sector is its ability to create jobs.</td>
<td>5</td>
<td>0.939</td>
<td>0.018</td>
</tr>
<tr>
<td>6</td>
<td>e. SMEs maintain the poverty alleviation activities through creating employment.</td>
<td>5</td>
<td>0.936</td>
<td>0.019</td>
</tr>
<tr>
<td>7</td>
<td>g. SMEs in general consider employees as their most important resources</td>
<td>5</td>
<td>0.842</td>
<td>0.074*</td>
</tr>
</tbody>
</table>

* Not significant

Proof of hypotheses

This section presents the results from the empirical studies. The findings were evaluated by considering the different formulated hypotheses one by one in the managers’ perspective.

Hypothesis 1
Hypothesis 1 assumes that SMEs are playing a very major role in the economy of Pakistan. The paired sample t-test and coefficient of correlation were carried out to test this hypothesis which shows t=-5.484 and p=0.005 which indicates that there is a positive impact of SMEs on the economy of Pakistan. Also the findings of the coefficient of correlation revealed that there is a positive and significant impact of SMEs on the economy of Pakistan, where r=0.986 and p=0.002. Consequently the hypothesis one under study is accepted.

Hypothesis 2
Hypothesis 2 purported that SMEs are the major source of foreign exchange earnings. In order to verify this assertion, the paired sample t-test and Pearson Product-moment correlation were used to test this hypothesis which indicates that SMEs have a positive and significant impact on foreign exchange earnings of Pakistan, where t=-4.576 and p=0.010. The results of the coefficient of correlation also showed positive and significant role of SMEs in foreign exchange earnings, where r=0.934 and p=0.020. Hence, the hypothesis two under study is also accepted.

Hypothesis 3
Hypothesis 3 states that SMEs have a major contribution in Pakistan’s GDP. To examine this proposition, the paired sample t-test and Pearson Product-moment correlation were used to test this hypothesis, which revealed that there is a major contribution of SMEs in the GDP of Pakistan. As a result hypothesis three under study is accepted on the basis of t=-4.495 and p=0.011. The findings of coefficient of coefficient also endorsed the positive role of SMEs in Pakistan’s GDP, where r=0.986 and p=0.002

Conclusions and implications

The study results revealed that Overall, there was a strong measure of agreement among the two responding groups. The similarity of opinion across these two groups was remarkable. In relation to perceived economic importance of SMEs, the significant difference of opinion was noted in all the seven items. While as far as coefficient of correlation among both the groups was concerned, the six statements were seemed to be significantly correlated whereas only one statement was not
Significantly correlated. This preceding analysis has demonstrated sufficiently that Pakistan’s small and medium enterprises (SMEs) owners/managers’ and employees’ decisions to enter in the process of economic development of the country by expanding export sub-sector, providing job opportunities and also poverty reduction from the country is not free of problems. This is an issue of highest importance in the exporting business, since the way these problems are perceived by SMEs often determines their future involvement in international business activities. SME sector of Pakistan being the largest economic sector in the country has a great contribution towards employment generation, domestic employment, reduction of un-employment in the country and provides job opportunities in rural areas of Sindh, province of Pakistan. Therefore, the Government, Small and Medium Enterprises Development Authority and SME Bank needs to take measures for the expansion, and development of the SME sector of Pakistan, which can play an important role in socio-economic development of the country.

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